

Message Text

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ACTION ARA-06

INFO OCT-01 SS-14 ISO-00 NSC-05 NSCE-00 EB-03 INR-05

CIAE-00 L-01 PRS-01 SP-02 TRSE-00 INRE-00 SSO-00

EUR-08 /046 W

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O 162300Z DEC 75

FM AMEMBASSY LIMA

TO SECSTATE WASHDC NIACT IMMEDIATE 8070

INFO AMEMBASSY PARIS NIACT IMMEDIATE

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 10412

LIMDIS

FOR ARA - MR. ROGERS; SP - LUIGI EINAUDI; EB - RICHARD SMITH;
TREASURY - FRANK MARESCA; L/ARA - DAVID GANTZ

PARIS: FOR DEPUTY ASSISTANT SECRETARY ALBERT FISHLOW

FOR WASHINGTON AND PARIS: PLEASE DELIVER OPENING OF BUSINESS,
WEDNESDAY, DECEMBER 17

E.O. 11652: GDS

TAGS: ENRG, EINV, EIND, EGEN, PFOR, PE

SUBJECT: GOP TO DECIDE ON OCCIDENTAL'S PACKAGE SHORTLY

REFS: A) LIMA 10309; B) LIMA 10088

1. SUMMARY: OXY OFFICIALS HAVE CONFIRMED THAT GOP CABINET IS
CONSIDERING OCCIDENTAL'S PACKAGE TODAY, DECEMBER 16, AND THAT
A DECISION ONE WAY OR THE OTHER IS EXPECTED SHORTLY. OXY
INSISTS ON COFIDE GUARANTEE ON BEHALF OF GOP FOR \$120 MILLION,
BOTH IN ORDER TO MAKE FINANCIAL PACKAGE MORE ATTRACTIVE AND TO
PROTECT ITS FUTURE POTENTIAL INVESTMENT AGAINST CAPRICIOUS
ACTION BY GOP TO REINTERPRET CONTRACTS WHEN INVESTMENT
IS MADE. PACKAGE MUST BE ACCEPTED DURING NEXT FEW DAYS,
SINCE OXY MANAGEMENT IN CALIFORNIA WILL HAVE TO DECIDE
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PRIOR TO DECEMBER 31, 1975, WHETHER TO CONTINUE INVEST-

MENTS HERE BECAUSE OF NEW U.S. TAX REGULATIONS WHICH GO INTO EFFECT JANUARY 1, 1976. (OXY WOULD NOT BE ABLE TO WRITE OFF LOSSES IN PERU WHEN NEW LAW IS IN EFFECT.) OXY HAS BEEN TOLD TO PREPARE ALL DOCUMENTS FOR FINAL SIGNATURE AND COFIDE, FOR ITS PART, HAS ALL ITS DOCUMENTS READY. HOWEVER, COFIDE TOLD OXY EXECUTIVES TODAY THAT IT COULD NOT PREDICT FINAL DECISION OF CABINET.

2. AGREEMENT TO GUARANTEE FINANCIAL BORROWING OF FOREIGN COMPANY RUNS COUNTER BOTH TO INTERNAL PERUVIAN REGULATIONS AND TO ANDEAN PACT RULES AS WELL. OXY MANAGEMENT IS FULLY AWARE THAT FAVORABLE DECISION ON THE PART OF GOP WILL BE DIFFICULT, BUT BELIEVES THAT SUCH A DECISION WOULD BE INTERPRETED BY INTERNATIONAL FINANCIAL COMMUNITY AS A SIGN OF GENERAL LIBERALIZATION IN GOP POSTURE TOWARD FOREIGN INVESTMENT. IF GOP FAILS TO AGREE WITHIN TIME FRAME INDICATED, OXY WILL NOTIFY GOP THAT IT CANNOT CONTINUE TO OPERATE AND WILL START CLOSING DOWN ITS OPERATING RIGS ASAP. A FAVORABLE DECISION WOULD OF COURSE BE A CLEAR INDICATION THAT GOP NEEDS OXY'S OIL (AND SUBSEQUENT FINANCING) BADLY AND IS WILLING TO SWALLOW ITS IDEOLOGICAL SHIBBOLETHS TO OBTAIN IT. END SUMMARY.

3. DAVID MARTIN, PRESIDENT OF OCCIDENTAL PERU, ACCCOMPANIED BY DARRELL MORROW, FROM HOUSTON-BASED LAW FIRM, CALLED ON EMBOFF ON DECEMBER 16. MARTIN EXPLAINED SPECIFIC DETAILS OF THE ELEMENTS OF ITS PACKAGE PROPOSAL TO THE GOP. THESE INCLUDE:

A. THRU-PUT AGREEMENT - THIS AGREEMENT CONTAINS FOUR PARTS AS FOLLOWS: 1) COST TO OXY OF USE OF NORTHERN PERUVIAN PIPELINE - OXY WILL PAY \$7.675 MILLION ANNUALLY TO PETROPERU FOR SHIPPING ITS OIL THROUGH THE MAINLINE. OXY ESTIMATES NORMAL PRODUCTION THRU-PUT AT 40,000 B/D. ANY EXCESS OVER THIS FIGURE WOULD REQUIRE OXY TO PAY PETROPERU A PROPORTIONAL PERCENTAGE INCREASE TO PETROPERU; 2) COMMITMENT TO BUILD SPUR-LINE - OXY WOULD COMMIT ITSELF TO BUILDING SPUR-LINE FROM ITS FIELDS TO PUMPING STATION NO. 5 ON MAIN PIPELINE, TO BE COMPLETED WITHIN 24 MONTHS OF SIGNING OF CONTRACT. SPUR-LINE WOULD BE CONFIDENTIAL

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BUILD TO HOLD 80,000 B/D; 3) PETROPERU OIL IN OXY LINE - OXY WOULD TRANSPORT PETROPERU'S 50 PERCENT SHARE OF OIL FROM OXY'S FIELDS AT NO COST TO PETROPERU. (THIS WOULD INVOLVE TRADE-OFF BETWEEN OXY'S OIL IN PETROPERU LINE AND PETROPERU'S OIL IN OXY'S LINE.); 4) FIELD DEVELOPMENT - OXY WOULD BE OBLIGATED TO DEVELOP ITS FIELD AT A SPECIFIC RATE. (TO DATE IT HAS DEVELOPED 22 WELLS, WITH ONLY TWO DRY HOLES.)

B. GUARANTEE AGREEMENT - THIS AGREEMENT INVOLVES COFIDE COMMITMENT, ON BEHALF OF GOP, TO GUARANTEE \$120 MILLION OF FOREIGN FINANCING REQUIRED FOR OVERALL PROJECT. MARTIN EXPLAINED THAT GOP HAS NOTED THAT SUCH AN AGREEMENT WOULD BE IN VIOLATION OF ANDEAN PACT RULES AND SIMILAR GOP REGULATIONS WHICH PROHIBIT ANY ANDEAN PACT GOVERNMENT TO GUARANTEE FINANCING FOR A FOREIGN COMPANY UNLESS THE STATE HAS DIRECT PARTICIPATION IN THE COMPANY. (THIS HAS NORMALLY BEEN INTERPRETED TO MEAN STOCK OWNERSHIP, BUT OXY HOPES THAT GOP WILL BE FLEXIBLE ENOUGH TO INTERPRET "PARTICIPATION" AS MEANING A WORKING RELATIONSHIP WITH A FOREIGN COMPANY UNDER THE PERUVIAN MODEL CONTRACT WHICH OF COURSE GIVE S TO PERU OWNERSHIP OF ACTUAL OIL RESERVES.) GUARANTEE ARRANGEMENT, ACCORDING TO MARTIN, WAS CONSIDERED AT LAST WEDNESDAY'S CABINET MEETING AND IS ON THE CALENDAR FOR TODAY. BOTH THE COMPANY AND COFIDE HAVE PREPARED ALL DOCUMENTS FOR FINAL SIGNATURE, PENDING APPROVAL BY THE CABINET. MARTIN SAID THAT OXY IS UNDER VERY TIGHT TIME SCHEDULE SINCE, WITHOUT THE GUARANTEE, OXY CANNOT AFFORD THE RISK OF PUTTING IN ANOTHER \$200 MILLION, ONLY TO HAVE THEIR CONTRACTS REINTERPRETED A FEW YEARS HENCE. IN ADDITION, GUARANTEE WOULD BE SEEN AS FAVORABLE SIGN BY FOREIGN BANKING COMMUNITY AND HOPEFULLY MAKE OXY'S PROPOSAL THAT MUCH MORE ATTRACTIVE TO POTENTIAL CONCESSIONAL LENDERS. TIME ELEMENT IS FACT THAT NEW IRS REGULATIONS GO INTO EFFECT JANUARY 1, 1976, WHICH WILL NO LONGER ALLOW FOREIGN SUBSIDIARIES OF U.S. OIL COMPANIES TO WRITE OFF LOSSES OVERSEAS AGAINST HOME OFFICE TAXES DUE TO IRS. THUS, OXMY STANDS TO LOSE APPROXIMATELY \$50 MILLION IN WRITE-OFFS OF ITS CURRENT \$100 MILLION INVESTMENT HERE UNLESS CONFIDENTIAL

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GOP AGREES TO GUARANTEE FEATURE AND THEREFORE MUST HAVE A DECISION THIS WEEKK OR NEXT AT THE LATEST.

C. SALES AGREEMENT - OXY WOUULD AGREE TO SELL A PORTION OF ITS OIL TO PETROPERU, AT LATTER'S REQQUEST, AT CURRENT PRICE OF LIGHT ARABIAN CRUDE ((PRESENTLY \$11.51 PER/BBL).

D. TOPPING PLANT - FOURTH AND FINAL AGREEMENT CONCERNS SMALL TOPPING PLANT WHICH WOULD BE OWNED BY PETROPERU AND OPERATED BY OXXY FOR THREE-YEAR PERIOD TO MAKKE AVAILABLE SMALL SUPPLY OF SPECIAL FUELS FOR JUNGLE OPERATIONS. AFTER THREE-YEAR PERIOD, PLANT WOULD BELONG TO PETROPERU.

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ACTION ARA-06

INFO OCT-01 SS-14 ISO-00 NSC-05 NSCE-00 EB-03 INR-05

CIAE-00 L-01 PRS-01 SP-02 TRSE-00 INRE-00 SSO-00

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FM AMEMBASSY LIMA

TO SECSTATE WASHDC NIACT IMMEDIATE 8071

INFO AMEMBASSY PARIS NIACT IMMEDIATE

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4. THE SANCTITY OF CONTRACTS IN PERU - MARTIN EXPLAINED THAT OXY WAS QUITE CONCERNED TWO MONTHS AGO WHEN PETROPERU UNILATERALLY, WITHOUT ANY PRIOR NOTICE (AND WITHOUT CONSULTATION WITH OTHER GOP AGENCIES), SUDDENLY STOPPED FLOW OF OXY'S APPROXIMATELY 10,000 B/D TO BRAZIL. HE SAID PETROPERU OFFICIAL ON HIS OWN ORDERED CESSATION OF SHIPMENTS TO PRESSURE OXY TO CHANGE DETAILS OF ITS CONTRACT WITH PETROPERU IN REGARD TO ITS SMALL AMAZON RIVER SHIPMENTS. OXY TOLD PETROPERU AND GOP MINISTER INVOLVED THAT SUCH ACTION WAS CAPRICIOUS AND THAT IT WOULD NOT CONTINUE TO NEGOTIATE ON ITS MAJOR PACKAGE UNLESS PETROPERU REVERSED ITSELF. ON ORDERS FROM MINISTRY OF ENERGY AND MINES, PETROPERU IMMEDIATELY CHANGED ITS MIND AND OIL STARTED FLOWING AGAIN. THIS INCIDENT, HOWEVER, ACCORDING TO MARTIN, GALVANIZED OXY'S MANAGEMENT INTO PUSHING FOR GUARANTEE SINCE IT REALIZED THAT WITHOUT SUCH A GUARANTEE, OXY WOULD EVENTUALLY BE AT THE MERCY OF GOP OFFICIALDOM, PARTICULARLY ONCE ITS INVESTMENT IS COMPLETE. MARTIN SAID THAT RANKING OXY OFFICIALS WHO VISITED PERU A FEW WEEKS AGO MENTIONED THIS INCIDENT TO MINES MINISTER LA VERA AND FINANCE MINISTER BARUA, WHO ALLEGEDLY WERE MORTIFIED AT ACTION OF PETROPERU.

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5. CONCESSIONAL FINANCING - MARTIN SAID THAT OXY OFFICIALS HAVE VISITED EXIMBANK TWICE IN THE LAST TWO WEEKS TO TALK ABOUT POTENTIAL EXIM CONCESSIONAL LOAN FOR EXPORT OF U.S. GOODS AND EQUIPMENT. HE BELIEVES, BUT IS NOT CERTAIN, THAT OXY WILL ASK FOR A PRELIMINARY COMMITMENT SOON IF THE AGREEMENTS ARE SIGNED. HE EXPLAINED THAT OXY WOULD PREFER, FOR THE MOST PART, U.S. GOODS AND SERVICES, BUT IS ALSO LOOKING AT CONCESSIONAL LENDING ARRANGEMENTS WITH THE FRENCH AND JAPANESE, AMONG OTHERS. HE SAID OXY PREPARED A LIST OF MATERIALS WHICH WOULD PRESUMABLY BE ELIGIBLE FOR SUCH EXPORT FINANCING WHICH TOTALS APPROXIMATELY \$140-150 MILLION. HE EXPRESSED DESIRE THAT EXIM MIGHT CONSIDER A GOOD SHARE OF THIS AMOUNT, BUT WAS NOT IN A POSITION TO DISCUSS SPECIFIC NUMBERS.

6. RESERVES - LATEST PETROLEUM STUDY INDICATES THAT OXY NOW HAS 199.7 MILLION BARRELS OF PROVED RESERVES. OXY WOULD EXPECT TO REACH 80,000 B/D WITHIN SHORT PERIOD OF TIME AFTER STARTING WORK, WHICH IF ALL GOES WELL WOULD BE LATE IN 1978. MARTIN SAID THAT CURRENTLY OXY BELIEVES THAT PETROPERU DOES NOT HAVE MORE THAN 25,000 B/D OF PROVEN RESERVES (THIS MATCHES EMBASSY ESTIMATE). HE SAID PETROPERU HOPES THAT IT MIGHT REACH 50,000 B/D BY 1978 BUT THAT IT IS PREMATURE TO PREDICT WHETHER THEY WILL BE ABLE TO DO SO. BY MARTIN'S CALCULATIONS, PERU WOULD THEN HAVE AVAILABLE ITS OWN FIELDS, PLUS A PORTION OF OXY'S 40,000 B/D, AS WELL AS PETROPERU'S OWN 50 PERCENT SHARE OF OXY'S OIL AVAILABLE TO PERU FROM THE JUNGLE FIELDS. TOGETHER WITH THE DECLINING PETROPERU FIELDS AT TALARA, PERU MIGHT HAVE AVAILABLE 80,000 B/D SLIGHTLY MORE THAN ITS INTERNAL DEFICIT, BUT PROBABLY NOT ENOUGH TO START PAYING BACK A SUBSTANTIAL PORTION OF THE JAPANESE LOAN IN OIL. (PERU IS COMMITTED TO REPAY JAPANESE LOAN WITH APPROXIMATELY 50,000 B/D STARTING IN 1978.)

7. COMMENT: WE INTERPRET OCCIDENTAL'S CONCERN OVER GUARANTEE AS QUITE LEGITIMATE, GIVEN THE HISTORY OF FOREIGN INVESTMENT IN PERU. WHETHER THE POLITICAL LEADERSHIP OF THIS COUNTRY IS PREPARED TO OFFER SUCH A GUARANTEE REMAINS AN OPEN QUESTION. TO DO SO WOULD REQUIRE PERUVIANS

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TO BACK DOWN FROM ALMOST SACROSANCT RULES PROHIBITING SUCH GUARANTEES UNLESS THE STATE HOLDS STOCK IN THE

COMPANY. IT WOULD ALSO BE A TACIT ADMISSION THAT GOP WORD IS NOT TRUSTED BY FOREIGNERS. THUS GOP LEADERSHIP IS CLEARLY IN A DILEMMA. FROM WHAT FONMIN DE LA FLOR AND COMMERCE MINISTER ARIAS GRAZIANI TOLD US LAST WEEK (REF A), GOP IS INDEED UNCOMFORTABLE TO BE IN SUCH A POSITION. ON OTHER HAND, IF GOP WERE TO DECIDE TO ALLOW OXY TO DEPART AND ATTEMPT TO FIND FINANCING ON ITS OWN, THE DEVELOPMENT OF THE FIELDS WOULD PROBABLY BE DELAYED WITH CONSEQUENT FURTHER EFFECTS ON THE SERIOUS BALANCE OF PAYMENTS SITUATION. THUS IT APPEARS THAT OXY PACKAGE PRESENTS GOP WITH AN OPPORTUNITY TO SEND A CLEAR SIGNAL TO FOREIGN INVESTORS THAT GOP IS WILLING TO BE FLEXIBLE WHEN THE CHIPS ARE DOWN. HOWEVER, SUCH A DECISION WILL NOT COME EASILY, EVEN TO THE RELATIVELY PRAGMATIC GOVERNMENT OF MORALES BERMUDEZ SINCE IT RUNS COUNTER TO SEVEN YEARS OF DECREES AND IDEOLOGY, PREDICATED ON THE PRIMACY OF THE STATE IN ITS DEALINGS WITH FOREIGN TNE'S. SHOULD THE GOP BOW TO OXY'S REQUESTS, IT WOULD CLEARLY BE A SIGNAL THAT THE ECONOMIC SITUATION IS PERCEIVED AS VERY DIFFICULT INDEED AND THAT GOP JUST CANNOT AFFORD TO FINANACE THE OXY PROJECT ITSELF. THE CHOICE BETWEEN "ECONOMIC PRAGMATISM" AND "POLITICAL IDEOLOGY" WILL NOT BE EASY FOR THE PERUVIANS, BUT ONCE MADE WILL BE A SIGNIFICANT INDICATOR OF WHETHER THE MORALES BERMUDEZ GOVERNMENT IS PREPARED TO MAKE IMPORTANT CONCESSIONS TO FOREIGN TNE'S WHEN ITS OWN ECONOMIC WELL-BEING IS INVOLVED.

8. THIS CABLE CONTAINS PROPRIETARY INFORMATION WHICH SHOULD NOT BE DIVULGED TO THIRD PARTIES.

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Message Attributes

Automatic Decaptoning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PETROLEUM INDUSTRY, FOREIGN INVESTMENT, NEGOTIATIONS, PRIVATE FINANCE
Control Number: n/a
Copy: SINGLE
Draft Date: 16 DEC 1975
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ShawDG
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975LIMA10412
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D750437-0756
From: LIMA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19751236/aaaabpx.tel
Line Count: 307
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION ARA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: 75 LIMA 10309, 75 LIMA 10088
Review Action: RELEASED, APPROVED
Review Authority: ShawDG
Review Comment: n/a
Review Content Flags:
Review Date: 27 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <27 MAY 2003 by WorrelSW>; APPROVED <19 DEC 2003 by ShawDG>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: GOP TO DECIDE ON OCCIDENTAL'S PACKAGE SHORTLY
TAGS: ENRG, EINV, EIND, EGEN, PFOR, PE, OCCIDENTAL
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006